Competition Issues in B2B Exchanges

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What are B2B Exchanges?

- Internet-based solutions linking businesses interested in buying and selling goods or services from one another
- Taxonomy of B2B exchanges
  - *Product use:* vertical (direct inputs) vs. horizontal (indirect inputs)
  - *Procurement method:* systematic vs. spot procurement
  - *Ownership:* buyer owned, seller owned, independent
  - *Functionality:* brokers, auctioneers, clearing houses
  - *Pricing:* catalogs, auctions, exchanges, negotiations
  - *Fee model:* transaction, membership, service, advertising

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B2B exchanges can provide substantial benefits

- Consolidate trade
- Increase market liquidity
- Reduce search costs
- Reduce transaction and administrative costs
- Improve supply chain management

"New-economy" economics of B2B exchanges

- B2B Exchanges exhibit indirect network effects
  - Expected utility increases with the *liquidity* of the exchange
    - Lower market price variance
    - Lower search costs
    - Lower transaction costs due to standardization
  - B2B exchanges may tip to monopoly
- B2B exchanges are vulnerable to coordination failure
  - If final equilibrium outcome is uncertain
  - If joining is costly

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Boom of B2B exchanges

Source: Day, Fein, Ruppersberger 2004

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Competition Issues - Foreclosure

- Exclusivity and discriminatory access may result in foreclosure
  - Exclusive distribution/purchasing may foreclose competing exchanges
  - Discriminatory access may foreclose competing sellers/buyers
- But they may help establish a successful exchange
  - Exclusivity may help solve coordination failure
  - Discriminatory access may help avoid free-rider problem
- Difficult to separate natural market outcomes from anticompetitive foreclosure
  - B2B exchanges may tip to monopoly
  - Are B2B exchanges essential facilities?

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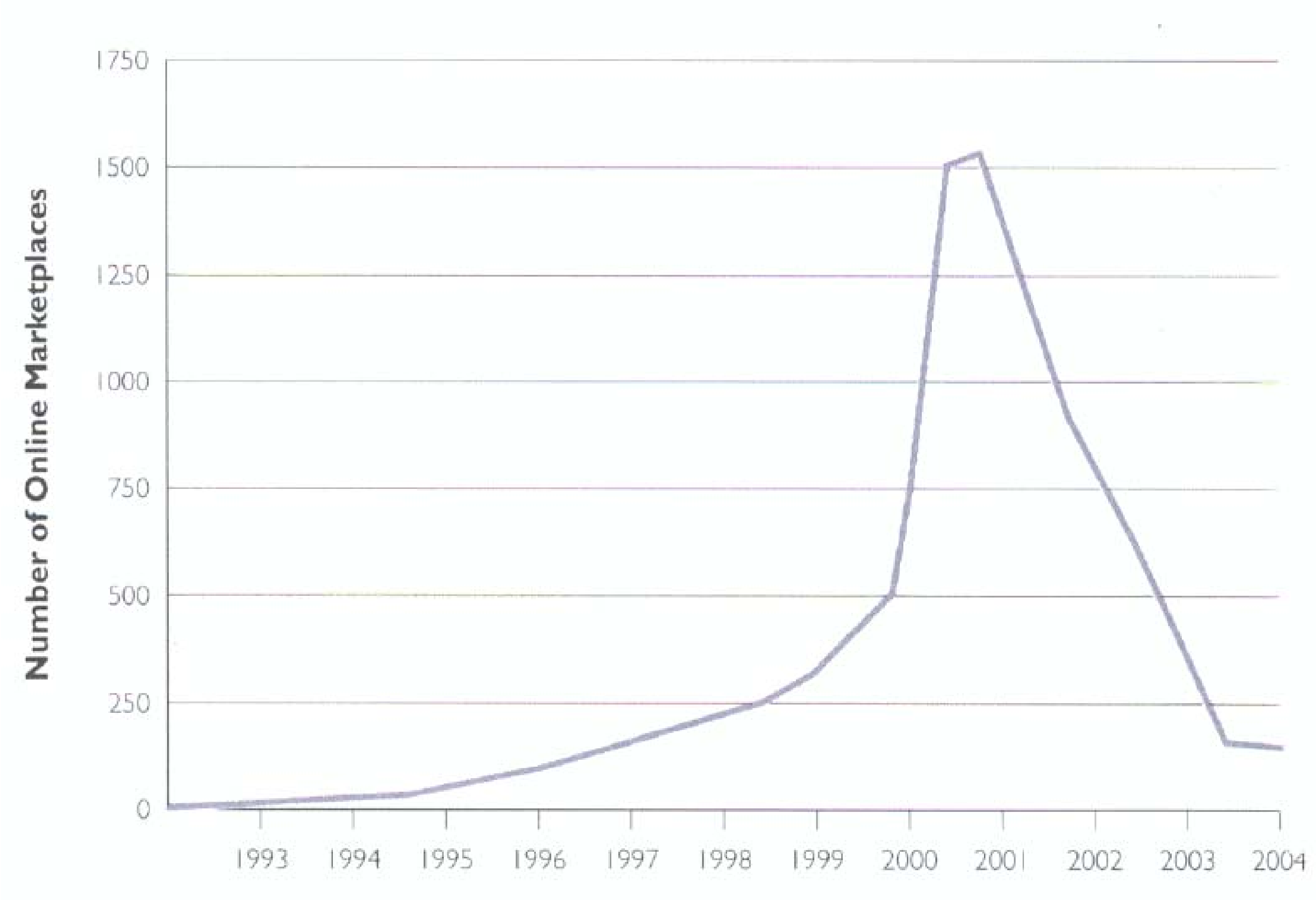
Competition Issues - Collusion

- B2B exchanges may increase price transparency
  - Competitors' prices may be observed
  - Posted prices may be used as a signal
- B2B exchanges may allow information sharing
  - May be problematic in the presence of exclusivity
  - More worrisome if disaggregated information is shared
- Are they needed to realize the benefits of the exchange?

Competition Issues – Mergers and JV

- Monopoly concerns
  - Standard analysis
- Monopsony concerns
  - Inextricably linked to the “consolidating trade” benefit
  - Joint purchasing is not routinely offered by B2B exchanges
  - Coordinated monopsony is more difficult to sustain
- Need to consider natural tipping when concerned with high market shares

B2B exchange shakeout



Source: Day, Fein, Ruppersberger 2004

Explaining the shakeout

- Reasons for B2B's bust
  - Very limited support from sellers, limited support from buyers
  - High cost of standardizing systems
  - Competitors found it difficult to cooperate
  - Concerns about posting business sensitive information
  - Generic new economy issues
- Private exchanges are the new wave of B2B
  - Few public exchanges survived
  - Most companies chose to implement private exchanges

“Old-economy” economics of B2B exchanges

- Cost of standardizing systems is very significant
- Sellers are wary of more intense competition
  - Reduction in search cost
  - Standardization
- Benefits for buyers are also uncertain
  - Aggregating sales benefits small buyers with little market power
  - Large buyers may have little incentive to participate
- No side payments, no surplus sharing
- B2B exchanges may be a Pareto-improving only when the industry is fragmented at all levels

Implications for competition analysis

- The competition analysis of B2B exchanges is not novel
  - Foreclosure
  - Collusion
  - Tradeoff between anticompetitive effects and efficiency benefits
- B2B history shows delicate interplay between
  - Costs
  - Efficiencies
  - Procompetitive effects
  - Anticompetitive effects
- Competition analysis has a rich history to draw from

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